

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-96297; File No. SR-FINRA-2022-021)

November 10, 2022

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)

I. Introduction

On July 28, 2022, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-FINRA-2022-021 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder to adopt a voluntary, three-year remote inspection pilot program (“Pilot”) to allow broker-dealers to elect to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and non-branch locations remotely without an on-site visit to such office or location, subject to specified terms.<sup>3</sup> The proposed rule change was published for public comment in the Federal Register on August 15, 2022.<sup>4</sup> On September 23, 2022, FINRA consented to an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See infra note 4.

<sup>4</sup> Exchange Act Release No. 95452 (Aug. 9, 2022), 87 FR 50144 (Aug. 15, 2022) (File No. SR-FINRA-2022-021) (“Notice”).

change to November 11, 2022.<sup>5</sup> On November 9, 2022, FINRA filed a letter stating it was still considering the comments to the Notice, and anticipates submitting a response to comments and amendments to the Notice in the near future.<sup>6</sup>

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act<sup>7</sup> to solicit comments on the proposed rule change and to institute proceedings to determine whether to approve or disapprove the proposed rule change.

## II. Description of the Proposed Rule Change

### A. Background

As stated in the Notice, the COVID-19 pandemic prompted FINRA to provide temporary relief to member firms from certain regulatory requirements.<sup>8</sup> For example, FINRA adopted temporary Rule 3110.17, effective since November 2020, to provide member firms the option to conduct inspections of their branch offices and non-branch locations remotely, subject to specified terms<sup>9</sup> FINRA stated in the Notice that it believes now is the time to assess possible

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<sup>5</sup> See letter from Sarah Kwak, Associate General Counsel, Office of General Counsel, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, Commission, dated September 23, 2022.

<sup>6</sup> See letter from Sarah Kwak, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated November 9, 2022, available at <https://www.finra.org/sites/default/files/2022-11/FINRA-2022-021-Response-to-Comments-11-09-2022.pdf>.

<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>8</sup> See Notice at 50147 and notes 28 and 29.

<sup>9</sup> See Exchange Act Release No. 90454 (Nov. 18, 2020), 85 FR 75097 (Nov. 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040). See also Exchange Act Release No. 93002 (Sept. 15, 2021), 86 FR 52508 (Sept. 21, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-023); Exchange Act Release No. 94018 (Jan. 20, 2022), 87 FR 4072 (Jan. 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001); Exchange Act Release No. 96241 (Nov. 4, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030). If the proposed rule change is approved, Rule 3110.17 would

longer-term rule changes regarding its inspection program and is, therefore, proposing a voluntary, three-year remote inspections pilot program.<sup>10</sup>

**B. The Proposed Rule Change**

The Notice states that Rule 3110(c)(1) currently provides that an inspection of an office or location must occur on a designated frequency, and that the periodicity of the required inspection varies depending on the classification of the location as an office of supervisory jurisdiction (“OSJ”), branch office, or non-branch location.<sup>11</sup> FINRA is proposing to amend FINRA Rule 3110 (Supervision) to adopt a voluntary, three-year remote inspection pilot program to allow member firms to elect to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and non-branch locations remotely without an on-site visit to such office or location, subject to specified terms described below (such members hereinafter referred to as “participating members”).

i. **Scope of Pilot**

Proposed Rule 3110.18(b)(1) would provide that a participating member may elect to conduct the inspection of an office or location during the pilot period remotely when the member reasonably determines that the purposes of the rule can be accomplished by conducting such required inspection remotely. Proposed Rule 3110.18(b)(1) would require a participating member to develop a reasonable risk-based approach to using remote inspections and conduct and document a risk assessment for an office or location prior to electing to conduct a remote

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automatically sunset on the effective date of proposed Rule 3110.18, if it has not already expired by its own terms. See Notice at 50152.

<sup>10</sup> See Notice at 50145.

<sup>11</sup> See id. at 50146.

inspection for that office or location. The risk assessment must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location.<sup>12</sup>

ii. Ineligible Offices and Locations

Under proposed Rule 3110.18(b)(2)(A), a member firm would be ineligible to conduct remote inspections of any of its offices or locations if any time during the period of the proposed pilot program, the member is or becomes designated as: (1) a Restricted Firm under Rule 4111(Restricted Firm Obligations); or (2) a Taping Firm under Rule 3170 (Tape Recording of Registered Persons by Certain Firms). Under proposed Rule 3110.18(b)(2)(B), a specific office or location of an otherwise eligible member would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is or becomes: (1) subject to a mandatory heightened supervisory plan under the rules of the Commission, FINRA, or state regulatory agency; (2) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under proposed Rule 3110.18(b)(2)(B)(i) or otherwise as a condition to approval or permission for such association; (3) subject to Rule 1017(a)(7) as a result of one or more associated persons at such location; or (4) one or more associated persons at such location has an event in the prior three years that required a “yes” response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4.<sup>13</sup>

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<sup>12</sup> See id. at 50148-49.

<sup>13</sup> See id.

iii. Written Supervisory Procedures

Proposed Rule 3110.18(c) would require a participating firm to adopt written supervisory procedures (“WSPs”) regarding conducting remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Proposed Rule 3110.18(c) also states that reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) a description of the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b); and (3) the use of other risk-based systems employed generally by the participating member to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.<sup>14</sup>

iv. Effective Supervisory System

Proposed Rule 3110.18(d) would reiterate that the requirement to conduct inspections of offices and locations is one part of a member’s overall obligation to have an effective supervisory system, and therefore a member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. In addition, proposed Rule 3110.18(d) would provide that a participating member’s remote inspection of an office or location would be held to the same standards for review applicable to on-site inspections as set forth under Rule 3110.12. Further, proposed Rule 3110.18(d) would provide that where a participating member’s remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., “red flags”),

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<sup>14</sup> See id. at 50150.

the member may need to impose additional supervisory procedures for that office or location, or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent physical, on-site visit on an announced or unannounced basis.<sup>15</sup>

v. Documentation

Proposed Rule 3110.18(e) would require a participating member to maintain and preserve a centralized record for each of the “pilot years”<sup>16</sup> that separately identifies: (1) all offices or locations that were inspected remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in proposed Rule 3110.18(d). In addition, under proposed Rule 3110.18(e) a participating member’s documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.<sup>17</sup>

vi. Data and Information to be Provided to FINRA

a. Data Collection

Proposed Rule 3110.18(f)(1) would require a participating member to collect separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with Rule 3110(c)(1), of:

- (A) the number of locations with an inspection—on-site or remote—completed during each calendar quarter;

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<sup>15</sup> See id.

<sup>16</sup> Proposed Rule 3110.18(h) would define the term “pilot year.”

<sup>17</sup> See Notice at 50150.

- (B) the number of locations in item (A) that were inspected remotely;
- (C) the number of locations in item (A) that were inspected on-site;
- (D) the number of locations in item (C) that were inspected on-site because of a “finding”;<sup>18</sup>
- (E) the number of locations in item (B) where findings were identified, the number of those findings, and a list of the most significant findings; and
- (F) the number of locations in item (C) where findings were identified, the number of those findings, and a list of the most significant findings. (Hereinafter collectively referred to as the “Collected Data”).<sup>19</sup>

Proposed Rule 3110.18(f)(1) would require a participating member to provide the Collected Data to FINRA, on a periodic basis (not to exceed quarterly), and in a manner and format determined by FINRA.<sup>20</sup>

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<sup>18</sup> Proposed Rule 3110.18(f) would define “finding” as an item that led to any remedial action or was listed on the member’s inspection report. See Notice at 50151.

<sup>19</sup> See Notice at 50150-51. If “pilot year one”, as defined by proposed Rule 3110.18(h), covers a period that is less than a full calendar year, proposed Rule 3110.18(f)(2) would require a participating member to collect separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with Rule 3110(c)(1), of: (A) the number of locations with an inspection completed during the full calendar year of pilot year one; (B) the number of locations in item (A) that were inspected remotely during the full calendar year of pilot year one; and (C) the number of locations in item (A) that were inspected on-site during the full calendar year of pilot year one. (Hereinafter collectively referred to as the “Pilot Year One Collected Data”). Proposed Rule 3110.18(f)(2) would require a participating member to provide Pilot Year One Collected Data to FINRA no later than December 31 of such first pilot year, and in a manner and format determined by FINRA. See Notice at 50151.

<sup>20</sup> See Notice at 50150-51.

b. Written Supervisory Procedures

Proposed Rule 3110.18(f)(1) would also require participating members to provide FINRA the requirements of their WSPs for remote inspections that account for: (1) procedures for escalating significant findings; (2) procedures for new hires; (3) procedures for supervising brokers with a significant history of misconduct; and (4) procedures related to outside business activities and “doing business as” (DBA) designations. Proposed Rule 3110.18(f) would require participating members to provide FINRA this information with the first delivery of the Collected Data, and thereafter with the first delivery of Collected Data made after any amendments to their WSPs for remote inspections.<sup>21</sup>

In addition, proposed Rule 3110.18(f)(3) would require participating members to establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of proposed Rule 3110.18(f).<sup>22</sup>

vii. Notice of Opting In and Opting Out of Proposed Pilot Program

Proposed Rule 3110.18(g) would require a participating member, at least five calendar days before the beginning each pilot year,<sup>23</sup> to provide FINRA an opt-in notice in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the participating member agrees to participate in the proposed pilot program for the duration of the pilot year and to comply with the requirements of Rule 3110.18. A participating member that provides the opt-in notice for a pilot year would be automatically deemed to have elected and agreed to participate

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<sup>21</sup> See id. at 50151.

<sup>22</sup> See id.

<sup>23</sup> See supra note 16.

in the proposed pilot program for subsequent pilot years until the pilot program expires. Proposed Rule 3110.18(g) would also require a participating member withdrawing from subsequent pilot years to, at least five calendar days before the end of the then current pilot year, provide FINRA with an opt-out notice in the manner and format determined by FINRA.<sup>24</sup>

viii. Failure to Satisfy Conditions

Under proposed Rule 3110.18(i), a member firm that fails to satisfy the conditions of proposed Rule 3110.18 would be ineligible to participate in the proposed pilot program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).<sup>25</sup>

III. Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-021 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposed rule change should be approved or disapproved.<sup>26</sup> Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,<sup>27</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting

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<sup>24</sup> See Notice at 50151. Proposed Rule 3110.18(g) would give FINRA authority to waive the applicable timeframes for the required opt-in or opt-out notices in exceptional cases and where good cause is shown. See id.

<sup>25</sup> See Notice at 50151-52.

<sup>26</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>27</sup> Id.

proceedings to allow for additional analysis and input concerning whether the proposed rule change is consistent with the Exchange Act and the rules thereunder.

#### IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with the Exchange Act and the rules thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>28</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

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<sup>28</sup> Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-FINRA-2022-021 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-FINRA-2022-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File No. SR-FINRA-2022-021 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. If comments are received, any rebuttal comments should be submitted on or before [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>29</sup>

Sherry R. Haywood,  
Assistant Secretary.

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<sup>29</sup> 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).